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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 219

UNITED STATES OF AMERICA, *Petitioner*

v.

THE ARCADE COMPANY, A CORPORATION, AND ARCADE COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Acting Solicitor General, on behalf of the United States of America, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Sixth Circuit entered in this case.

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 21-26) are reported at 97 F.

Supp. 942. The opinion of the Court of Appeals, as amended on denial of rehearing (R. 127-134, 138), is reported at 203 F. 2d 230.

JURISDICTION

The judgment of the Court of Appeals was entered on April 7, 1953. (R. 127.) Its orders amending its opinion and denying the Government's petition for rehearing were entered on May 4, 1953. (R. 138.) The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

The stockholders of a corporation, in accordance with a preconceived plan, caused the corporation to be liquidated and dissolved. They received the assets and, pursuant to the plan, immediately transferred the property to a newly organized corporation which continued to conduct the same business.

1. The primary question is whether the court below erred in holding that, since the corporate assets were not conveyed directly from the old corporation to the new and were temporarily held by the stockholders before being transferred to the new, there was no corporate "reorganization" as defined in Internal Revenue Code Section 112 (g)(1)(D).

2. The secondary question is whether, regardless of whether there was a "reorganization", the ex-

penses incurred by the old corporation relating to the discontinuance of its business or to the future conduct of the business by a new corporation were deductible as ordinary and necessary business expenses under Code Section 23 (a)(1)(A).

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Regulations are set forth in the Appendix, *infra,* pp. 18-25.

STATEMENT

The taxpayer corporation, Arcade Company, organized in 1902, had only capital stock outstanding. Its stockholders made complaints about this capital structure because it was not as advantageous as that of other corporations which had issued bonds in addition to stock to their stockholders and which could, therefore, distribute earnings in the form of interest on the bonds and take deductions for such distributions. Accordingly, a tax consultant and attorneys were employed to work out and present a plan to minimize federal taxes and, if possible, to secure a larger distribution of the corporation's earnings to its stockholders. (R. 22, 34-36.)

The tax consultant presented a plan which the directors of the taxpayer corporation estimated would mean a benefit to the stockholders of $8 or more per share annually. The plan called for dissolution of the taxpayer corporation and the organization of a new corporation (to be known as

the Arcade Company, Inc., or The Arcade Corporation) to which would be transferred the property of the old corporation, after it was acquired by the stockholders in liquidating the taxpayer corporation; the stockholders were to receive stock and bonds in proportion to their ownership of stock in the taxpayer corporation. Such details as the amount of bonds proposed and the essential provisions of the bonds were also set out in the plan. (Ex. 1; R. 23, 36-38, 74.)

The District Court found that, although no resolutions were passed approving this plan, it was adopted and carried out in detail by the taxpayer corporation, its stockholders and directors. (R. 22-23, 25.) By letter dated July 12, 1943, the president of the taxpayer corporation submitted the plan to the stockholders stating that it had been informally approved by the directors; that, before taking formal action in the matter, the directors desired to have the stockholders' comments or approval of the proposed plan; and that, since it was to the advantage of every stockholder that the plan be put into effect at the earliest possible moment, their prompt attention was requested. (Ex. 1; R. 36-38, 74.) Mr. Walter Stokes, Jr., secretary-treasurer and director of the taxpayer corporation, testified that there was a response to that letter generally approving that a dissolution take place and that a new corporation be formed in accordance with the plan. (R. 33, 69.)

At a meeting on September 22, 1943, the stockholders of the taxpayer corporation resolved to dissolve the corporation and surrender its charter on September 30, 1943. Their resolution also provided for the appointment of Mr. Stokes and Mr. Einer Neilson, another director, as liquidating trustees in whom the assets of the dissolved corporation should be vested for disposition to, or as directed by, the stockholders. (R. 33, 65-66.) Two days after this meeting of the stockholders on September 24, 1943, Mr. W. E. Steger, president and director of the taxpayer corporation, and Messrs. Stokes and Neilson, organized the new corporation, the Arcade Company, Inc. (R. 33, 52, 54.) On the same day, September 24, 1943, the taxpayer corporation sent a letter to its stockholders enclosing a form letter to be used by them in directing the liquidating trustees to transfer the assets to such new corporation. (R. 44.) The form letter referred to, and directed detailed compliance with, the tax consultant's plan. (Ex. 5; R. 47-49.) The transmittal letter cautioned the stockholders in signing the form letter to bear in mind that the date should be no earlier than September 30th. To certain stockholders (trust companies having their own legal departments) the transmittal letter also pointed out that, while changes in form might be made in the enclosed letter to the liquidating trustees, its essential content was to be preserved. (R. 46.)

On September 30, 1943, the taxpayer corporation was dissolved and its assets were vested in Messrs. Stokes and Neilson as liquidating trustees. (R. 44, 68.) Under date of September 30, 1943, Messrs. Stokes and Neilson received from the taxpayer's stockholders, by means of the form letters which had been transmitted to them on September 24, 1943, instructions with respect to disposition of such assets. (R. 67.) On the next day, October 1, 1943, Messrs. Steger, Stokes and Neilson held their first meeting as incorporators of the new corporation. (R. 52.) At that meeting, by appropriate resolutions, they received and accepted the offer which as liquidating trustees Messrs. Stokes and Neilson were authorized to make with respect to the assets of the taxpayer which had vested in them on the previous day. (R. 25, 52-53.) On the same day, October 1, 1943, by appropriate instruments, the liquidating trustees conveyed the assets in kind to the new corporation, and the new corporation issued to the stockholders of the taxpayer corporation one share of stock of the new corporation and two bonds of $100 each for each share of stock of the taxpayer corporation. (R. 24, 68, 70, 79.) The new corporation took over the property of the taxpayer corporation subject to existing leases, and has continued to carry on the business of leasing such property formerly conducted by the taxpayer corporation. (R. 25.)

In suing the United States for a refund of excess profits tax, the taxpayer corporation contended that certain expenditures by it in connection with this plan should be deductible as ordinary and necessary expenses in carrying on a trade or business because they were made in connection with its dissolution and liquidation. The Government maintained that the expenditures, which consisted of payments made for accounting, legal and appraisal services, rendered in connection with the plan described above, should be treated as capital expenditures rather than deductible current expenses. (R. 2-6, 14-16, 23-24.) The new company, Arcade Company, Inc., successor to the assets and liabilities of the taxpayer corporation, was, on motion of the Government, also made a party to the action. (R. 17-18, 81.)

At the conclusion of the trial, on December 6, 1949, the District Court filed a memorandum opinion. This opinion pointed out that there was no substantial difference between the facts in the instant case and those in *Survaunt* v. *Commissioner,* 162 F. 2d 753 (C.A. 8th), and that substance should prevail over form; it concluded that the expenditures of the taxpayer corporation were made in effecting a reorganization as defined in Section 112 of the Internal Revenue Code, and that the expenses were not deductible. (R. 114-118, 123.) Approximately 17 months later, however, on May 8, 1951, the District Court filed findings of

fact and conclusions of law in which, upon findings not at variance with the facts stated in its previous opinion, it was concluded that there had been no reorganization and that the expenditures were deductible. (R. 21-26.) Judgment having been entered for the taxpayer corporation (R. 27) and the Government's motion for a new trial having been denied (R. 28, 120), the Government appealed to the United States Court of Appeals for the Sixth Circuit (R. 122).

The Sixth Circuit affirmed, holding that in a reorganization under Section 112 (g)(1)(D) of the Code the transfer of corporate assets must be made directly from the old corporation to the new one, and, apparently, that each corporation must expressly adopt the plan of reorganization in its entirety. On this view, the court concluded that there was no reorganization in the case at bar. Considering the expenditures by the taxpayer corporation under the circumstances to have been made in connection with its dissolution and liquidation, and rejecting the Government's argument that even in that light the expenditures would represent expenses of discontinuing rather than of carrying on a trade or business, the Sixth Circuit further held that the expenditures were deductible. (R. 134.) Orders were subsequently entered amending the court's opinion and denying the Government's petition for rehearing. (R. 138.)

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In holding that in a reorganization under Section 112 (g)(1)(D) of the Internal Revenue Code the corporate assets must be transferred directly from the old corporation to the new one.

2. In holding that a plan of reorganization is not adopted by the parties to such reorganization when each adopts and carries out that portion of the plan involving action by it.

3. In failing to hold that the transaction in the instant case constituted a reorganization as defined in Section 112 (g)(1)(D) of the Internal Revenue Code.

4. In failing to hold that, whether or not there was a reorganization, the expenditures made by the taxpayer corporation for accounting, legal and appraisal services were not deductible as ordinary and necessary expenses in carrying on a trade or business.

REASONS FOR GRANTING THE WRIT

The important tax question posed by this case arises in the familiar, recurring situation where the stockholders of a corporation, desirous of altering the capital structure or motivated by other business considerations, cause the corporate assets to be transferred to a successor corporation which thereafter continues to operate the same business.

Congress has provided for the non-recognition of gain or loss when, under described circumstances, the ownership interests of a corporation and of its stockholders are readjusted under modified corporate forms. When such a corporate modification, defined as a "reorganization" in Code Section 112 (g)(1) (Appendix, *infra,* pp. 19-20), takes place, the resulting exchanges of assets, stock and securities will not result in immediate taxable consequences to the corporation. One of these types of non-taxable reorganizations consists of the transfer by a corporation of all or part of its assets to a new corporation, with the stockholders of the old being in control of the new. Section 112(g)(1)(D), Appendix, *infra,* p. 20. Each of the corporations is "a party to a reorganization" (Section 112 (g)(2), Appendix, *infra,* p. 20), and no gain or loss is to be recognized to the old corporation, as a party to the reorganization on the transfer of its property pursuant to the plan of reorganization (Section 112 (b)(4), Appendix, *infra,* p. 19), or to the stockholders who, pursuant to the plan of reorganization, receive stock and securities in the new corporation in exchange for their stock and securities in the old corporation (Section 112 (b)(3), Appendix, *infra,* p. 19).

The pivotal issue in this case[1] turns on the proper

[1] The ultimate tax issue concerns the deductibility under Code Section 23 (a)(1)(A) (Appendix, *infra,* p. 18,) of expenses incurred by the old corporation. If those expenses

interpretation to be given to these inter-related phrases, "reorganization" (as defined in Section 112 (g)(1)(D)), "party to a reorganization" (as used in Section 112 (b)(3) and (4) and as defined in Section 112 (g)(2)), and "in pursuance of the plan the reorganization") as used in Section 112 (b)(3) and (4)). Instead of the corporate assets being conveyed directly from the old corporation to the new, the assets were first transferred to liquidating trustees for the stockholders and then were immediately transferred to the new corporation which continued to operate the business and which issued its stock and securities directly to the old stockholders. All of this, as found by the District Court, was done in accordance with a prearranged plan adopted and carried out by the old company and its stockholders. (R. 23.) Because the transfer of the corporate assets was not made directly from the old company to the new, and because title to the property was momentarily routed to the liquidating trustees, the court below ruled that there was no "reorganization", that neither corporation was a "party to a reorganization", and that there was no "plan of reorganization."

We believe that the crucial statutory language has been erroneously applied and interpreted by

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were incurred in connection with a non-taxable transfer of its assets to the new corporation, they were non-deductible, capital expenditures. See *Survaunt* v. *Commissioner*, 162 F. 2d 753, 754 (C.A. 8th).

the court below. Its decision is in direct conflict with that of the Court of Appeals for the Eighth Circuit in *Survaunt* v. *Commissioner,* 162 F. 2d 753, and is opposed, in principle, to the rulings of this Court. The problems raised by the decision are important in the proper application of the "reorganization" sections of the statute, since they are recurrent and of vital concern to corporations and stockholders, as well as to the Government.

1. *Survaunt* v. *Commissioner,* 162 F. 2d 753 (C.A. 8th), which the trial court at first thought was dispositive of the issue (R. 118), and which the Court of Appeals ignored altogether, also involved a situation where the stockholders desired to alter the capital structure of the corporation. To achieve that goal, and in accordance with a preconceived plan, they caused the corporation to be liquidated and dissolved; the corporate assets were distributed to the stockholders on liquidation and they immediately transferred the assets to a newly organized corporation in exchange for all its stock and securities. Since the entire transaction was integrated, and since the plan followed by the parties contemplated that the assets of the old corporation should ultimately be acquired by the new, it was held that there was a "reorganization" in which the old corporation exchanged its assets by procuring for its stockholders the stock and securities of the new company. Although title to the

corporate assets temporarily reposed in the stockholders before being transferred to the new corporation, it was held, contrary to the decision below (R. 130), that the exchange was made by the old corporation, thus satisfying the requirements of Section 112 (b)(4).[2]

The *Survaunt* case cannot be distinguished on the ground that there the Tax Court had found that conveyance of the assets to the stockholders and the reconveyance by them to the new corporation was done pursuant to an overall program which made this but a step in a single plan. In the present case, too, the District Court expressly found that the plan called for dissolving the old corporation and having the stockholders reconvey the assets to the new and that this plan (R. 23) "was adopted and carried out in detail by The Arcade Company [the old corporation], its stockholders and directors."[3] And in holding (R. 131) that, to comply with the statutory terms, the plan of re-

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[2] One of the issues in the *Survaunt* case concerned the deductibility of expenses incurred by the new corporation. Holding that these were incurred in connection with a nontaxable reorganization, the court held that the expenditures were capital in nature and non-deductible. See fn. 1, *supra*, pp. 10-11.

[3] In *Henrickson* v. *Braicks*, 137 F. 2d 632 (C.A. 9th), on which the court below relies heavily (R. 132-133), there was no finding of a plan, such as existed and was carried out here, for continuance of all the stockholders in the new company, and the Ninth Circuit stressed (at considerable length) the provisions for buying out stockholders of the old company who would not purchase shares in the new corporation.

organization must be adopted as such by formal corporate resolutions, the decision below is also in clear conflict with *Survaunt* where no such formal resolutions were adopted. See also *C. T. Inv. Co.* v. *Commissioner,* 88 F. 2d 582 (C.A. 8th).[4]

2. The holding below is likewise opposed to the principle of this Court's decision in *Helvering* v. *Limestone Co.,* 315 U.S. 179, where a reorganization was held to have resulted when the new corporation acquired its property, not from the old corporation, but from a creditors' committee which had obtained the assets as a result of bankruptcy proceedings. The Court said (pp. 184-185)—

> the separate steps were integrated parts of a single scheme. Transitory phases of an arrangement frequently are disregarded under these sections of the revenue acts where they add nothing of substance to the completed affair. *Gregory* v. *Helvering,* 293 U.S. 465; *Helvering* v. *Bashford,* 302 U.S. 454. Here

[4] The court below stresses (R. 131, 138) a portion of the Treasury Regulations, dealing with the "records to be kept and information to be filed with returns" (*infra,* p. 25), which refers to adoption of the plan of reorganization by each of the corporate parties. But this regulation concerns only the documents to be filed with the Commissioner by taxpayers claiming the benefits of a "reorganization", and was designed to provide data to enable the Commissioner to fulfill his statutory duty of investigating returns. This procedural regulation, directed at taxpayers claiming under the "reorganization" provisions, does not modify the substantive conditions and requirements. See R. 137.

> they were no more than intermediate procedural devices utilized to enable the new corporation to acquire all the assets of the old one pursuant to a single reorganization plan.

Accord: *Palm Springs Corp.* v. *Commissioner,* 315 U.S. 185.

This Court and the lower courts, in a variety of circumstances, have consistently held that where an integrated transaction is broken up into a series of related steps, intermediate formal measures taken to achieve the ultimate goal are to be disregarded and, specifically, that a circuitous routing of title to property in such circumstances will not alter the taxable consequences which Congress intended should result from a direct transfer. See *Commissioner* v. *Court Holding Co.,* 324 U.S. 331, 334; *Griffiths* v. *Commissioner,* 308 U.S. 355, 357-358; *Minnesota Tea Co.* v. *Helvering,* 302 U.S. 609, 612-614; *Gregory* v. *Helvering,* 293 U.S. 465, 469-470; *Helvering* v. *Bashford,* 302 U.S. 454, 458. Cf. *Higgins* v. *Smith,* 308 U.S. 473, 476-478. The court below ignored this well settled principle in holding that the temporary vesting of title in the stockholders meant that the old corporation did not transfer the property to the new and that this momentary intermediate step prevented the old corporation from being a party to a reorganization. Since the stockholders acted only as temporary conduits in transferring the assets to the new

corporation, as was intended from the very beginning, the taxable consequences should be the same as though the transfer had been made directly from the old corporation to the new. Nor is it any answer to suggest, as did the court below (R. 130), that the stockholders were free to change their plan. The same was true, for example in *Commissioner* v. *Court Holding Co., supra,* and this circumstance is obviously of little or no weight in the corporate modifications of most smaller businesses.

3. This is an issue of considerable importance in the administration of the income tax law. If the stockholders of a corporation who, in all other respects, comply with the statutory requirements of a non-taxable reorganization can, as held by the court below, alter the tax consequences prescribed by Congress through the simple expedient of temporarily taking title to the corporate assets before transferring the property to the new corporation, a mechanical test has been created whereby the applicability of the statute will turn on the presence or absence of a meaningless formality, and these reorganization provisions of the Code will come into play only where the taxpayer foresees a tax advantage. For it would always be easy to avoid a reorganization when it is to the taxpayers' interest to do so; when on the other hand a reorganization is desired, the intermediate step will be eliminated.

Since these corporate modifications are constantly occurring in the business world, the issue has a large and continuing significance and merits resolution by this Court.[5]

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

OSCAR H. DAVIS,
Acting Solicitor General.

JULY, 1953.

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[5] In addition to the taxpayer corporation and its stockholders, the issue in this particular case is also of concern to the new corporation, since the basis of the property acquired by that corporation and the basis of the new securities received by its stockholders are determined by the presence or absence of a reorganization (see Code Sections 113(a)(6) and (7)). Arcade Company, Inc., the new corporation, is plaintiff in Civil Action No. 1657, a suit for refund of approximately $61,000 in taxes, now pending in the United States District Court for the Middle District of Tennessee. There, the issue concerns the proper basis for depreciation of the property acquired at the time of incorporation and there, as here, the question whether the transactions in question constituted a reorganization is crucial. A request has been made that proceedings in that case be held in abeyance pending a final decision of this case.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) [as amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) *Exchanges Solely in Kind.*—

* * * * *

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(g) [as amended by Sec. 121(d)(4) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Definition of Reorganization.*—As used in this section (other than subsection (b)(10) and subsection (l)) and in section 113 (other than subsection (a)(22)).—

(1) [as amended by Sec. 213(b) of the Revenue Act of 1939, c. 247, 53 Stat. 862]

The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

(26 U.S.C. 1946 ed., Sec. 112.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.112(g)-1 [as amended by T.D. 5402, 1944 Cum. Bull. 229]. *Purpose and scope of exception of reorganization exchanges.—Reorganization*: As used in sections 29.112 (g)-1 to 29.112(g)-6, inclusive, the terms "reorganization" and "party to a reorganization" mean only a reorganization or a party to a reorganization as defined in section 112(g). With respect to section 112 (b)(10) reorganizations, see section 29.112 (b)(10)-1.

Purpose: Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or

in extent, from the old property. The purpose of the reorganization provisions of the Internal Revenue Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Code, as are required by business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Code are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. The Code recognizes as a reorganization the change (made in a specified way) from a business enterprise conducted by a single corporation to the same business enterprise conducted by a parent and a subsidiary corporation, but not the creation of a temporary subsidiary as a device for the making of an ordinary dividend. The Code recognizes as a reorganization the amalgamation (occurring in a specified way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the req-

uisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. Accordingly, under the Code, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale, even though the mechanics of a reorganization have been set up.

* * * * *

The provisions of the Internal Revenue Code referred to in the preceding paragraph of this section are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112(g) and for the bona fide consummation of each of the requisite acts

under which non-recognition of gain is claimed. Such transaction and such acts must be an ordinary and necessary incident of the conduct of the enterprise and must provide for a continuation of the enterprise. A scheme which involves an abrupt departure from normal reorganization procedure, devised and adopted with reference to a transaction on which the imposition of the tax is imminent, is not a plan of reorganization.

SEC. 29.112(g)-2. *Definition of terms.*—* * *

* * * * *

The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 112(g)(1). The term is not to be construed as broadening the definition of "reorganzation" as set forth in section 112(g)(1), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges as are directly a part of the transaction specifically described as a reorganization in section 112(g)(1). Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 112(g)(1), but the readjustments involved in the exchanges effected in the

consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 112(g)(1) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

* * * * *

SEC. 29.112(g)-6. *Records to be kept and information to be filed with returns.*—(a) The plan of reorganization must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of the corporation. * * *

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Internal Revenue Code:

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Sec. 23(a)(1)(A), Title 26 U.S.C.A., Sec. 23(a)(1)(A) 4,16

1932 Tenn. Code, Secs. 3756, 3757 6,17

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 219

UNITED STATES OF AMERICA, *Petitioner*,

v.

THE ARCADE COMPANY, A CORPORATION, AND ARCADE COMPANY, INC., *Respondents*.

BRIEF IN OPPOSITION TO THE GRANTING OF THE WRIT OF CERTIORARI

QUESTIONS PRESENTED

1. The principal question presented is whether the Court below erred in holding that where a corporation goes into voluntary liquidation and the corporate assets are conveyed to liquidating Trustees for the stockholders, all being done as provided in the laws of the State of Tennessee, and the Trustees, pursuant to directions of the stockholders as owners, convey to a new corporation, there was no corporate reorganization as defined in the Internal Revenue Code, Sec. 112(g), Title 26 U.S.C.A., Sec. 112(g).

2. A secondary question is whether or not the reorganization expenses incurred by the old corporation relating to the discontinuance of its business and in connection with its liquidation were deductible as ordinary and necessary business expenses under the Internal Revenue Code, Sec. 23(a)(1)(A), Title 26 U.S.C.A., Sec. 23(a)(1)(A).

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 21–26) are reported at 97 F. Supp. 942. The opinion of the Court of Appeals, as amended on denial of rehearing (R. 127–134, 138), is reported at 203 F.(2d) 230.

CONTENTIONS OF THE PARTIES

It is the insistence of the Government that the execution of the tax plan involved in this case constituted a reorganization as that term is defined in the Federal statutes, and that each act done pursuant thereto should be treated as a single transaction for tax purposes, which constituted a reorganization, and the expenditures of the taxpayer in executing the tax plan were not deductible as ordinary and necessary expenses in carrying on a trade or business; further, that such costs represent capital expenditures rather than current expenses; and that in the event it is held that there was no reorganization, such expenditures did not constitute ordinary and necessary expenses in carrying on a trade or business, and were not deductible as such.

The Respondents contend that the tax plan provided for a liquidation of the old corporation, The Arcade Company, under applicable Tennessee statutes, terminating its right to do business completely and forbidding further corporate action; that it was completely liquidated according to the laws of the State of Tennessee, and took no further action of any kind. After liquidation a new corporation was formed by the former stockholders, and the assets of the old company, which had been transferred to Trustees for the stockholders, were then sold to the newly formed corporation, Arcade Company, Inc., for a valuable consideration, at the direction of the real owners of these assets; that the costs and expenses of this procedure were necessary business expenses and were deductible; and that the Government cannot by rules or regulations, or arbitrary interpretation of the statutes, circumvent the purposes of valid laws, either State or Federal, under which a corporation is legally dissolved, and after which it can take no further action as a corporation. This was the careful and deliberate plan of the stockholders, acting as individuals, and was carefully and deliberately carried out in a legal manner.

The old corporation, The Arcade Company, as shown by the proof, under existing tax laws, could not earn a fair return on its investment, which made it necessary that something be done to permit a fair return on the corporation's actual worth. (R. 34–35). The tax plan was suggested by accountants and attorneys employed by the old corporation and was adopted by stockholders (not by old corporation) and carried out accordingly (R. 36, et seq.). It is emphasized here that the laws of Tennessee expressly

provide that a corporation may dissolve, vest its assets in Trustees for the benefit, first, of its creditors and second of its shareholders, and the Trustees can make any disposition of assets which the shareholders direct. (1932 Tenn. Code, Secs. 3756, 3757) (See Appendix.) That was done in this case, under the advice of the counsel employed. It is further emphasized, as stated above, that there was a complete surrender of the charter of the old corporation, The Arcade Company, which thereupon went out of business and took no further corporate action (R. 44), and had no dealing of any kind with the new corporation.

The Trustees to whom the assets of the old corporation had been transferred, pursuant to an agreement of sale made with the new corporation, Arcade Company, Inc., then transferred all of the properties vested in them to the new corporation for a valuable consideration. This was a transaction entirely between the Trustees and the new corporation in which the old company had no part, it having ceased to exist and liquidated. There were never any dealings or negotiations between the old and new corporations. The stockholders of the old company, became the equitable owners of all the assets of the old company, and were free to dispose of them in such way as they pleased. They voluntarily chose to form a new company, to receive and administer these assets, which resulted in stockholders of both companies being the same. No stockholder was compelled to accept stock in the new company, but voluntarily did so, and, in fact, certain stockholders who were Trustees for others took some time in deciding on their course of action, and one of them

even instituted a Court proceeding asking authority so to do before consenting to the plan. (R. 50–51).

As a result of carrying out the plan, the stockholders of the old corporation paid income tax on what they received for their stock as a liquidating dividend. (R. 77–78, 105–107).

It is further the position of the Respondents that the expenses in question were incurred for the benefit of the old corporation. At the time of the appraisal there was no new corporation, since it had not been organized. At the time of liquidation the old company was required to file with the Internal Revenue Bureau a final report showing the value of assets distributed to the stockholders (R. 77), and the appraisal was made for this purpose; therefore, expenses were incurred as a necessary and legitimate business expense incident to working out the plan, and all that was done was permitted by the provisions of the applicable laws, and the payments to accountants, attorneys and appraisers are deductible as necessary business expenses.

HOLDING OF THE COURT OF APPEALS

The Court of Appeals gave full consideration to the provisions of the Internal Revenue Code relied on by the Government in its petition as supporting its Specification of Errors. Its application of these provisions to the facts of this case are fully set forth and discussed (R. 130–131). Controlling factors in applying the provisions of the Code relied on by the Government, and in holding that there was no reorganization thereunder were:

1. The charter of the old company was surrendered and the corporation was dissolved before the new corporation was organized, hence there could be no transfer by the old corporation of its assets to the new corporation.

2. There was no conveyance of property by the old corporation to the new corporation for the latter's stock, nor were there any agreements or dealings between the old and new corporations, or exchanges between them pursuant to a plan of reorganization.

3. When the old company was dissolved it was ended and liquidated, and it retained no right to enforce any agreement to be performed subsequent to its dissolution.

4. The assets of the old company were transferred to Trustees for the benefit of its former stockholders, and the former stockholders paid income tax in the way of capital gains tax on what they had received from their stock as a liquidating dividend.

5. The old corporation had no rights or obligations regarding the formation of a new corporation or to see that the Trustees entered into such a plan or transferred the assets to a new corporation.

6. The former stockholders, at the time of liquidation of the old corporation, were absolute owners of the corporate assets and were free as to the disposition of these assets. They were not bound to carry out any definite plan for disposition or management of these assets.

7. The new corporation, when organized, had no rights of any kind to the assets owned by the stockholders of the old company; no rights whatever with respect to the old corporation, or with respect to former stockholders of the old company; but all it did was the result of dealings after the old company was fully liquidated.

8. Regarding the meaning of the term "plan of reorganization," as specified by the statute, the Court of Appeals said:

> "But the 'plan of reorganization,' specified by the statute, is not just any suggestion or advice received from a lawyer or a tax accountant, even though it be acted upon by either a corporation, or its stockholders, or both. 'The plan of reorganization must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of the corporation.' Treasury Reg. 103, Section 19.112(g)-6, Title 26 Code of Federal Regulations, 29.112(6)-6. When the old corporation was dissolved and the assets were transferred to its former stockholders, there was a break in the continuity of ownership, for, as a general rule, a corporation and its stockholders are deemed separate entities; and this is true in respect to tax problems. New Colonial Ice Co., Inc. v. Helvering, 292 U.S. 435. The dissolution of the old company and the transfer of its assets to its former stockholders put a period to its existence. The new

company was a different and separate enterprise."

(*R. 130–131*)

THERE IS NO CONFLICT BETWEEN THE DECISION OF THE SIXTH CIRCUIT COURT OF APPEALS IN THE INSTANT CASE AND THE DECISIONS OF OTHER CIRCUIT COURTS OF APPEALS.

Questions of the kind presented in the instant case are necessarily dependent for decision to a large extent on the facts of the individual case and the provisions of applicable law must be applied in the light of such facts. It is our insistence that the Court of Appeals has done exactly this, and that the facts of the instant case differ materially from those in the cases relied on by the Petitioner as conflicting with the decision of the Sixth Circuit.

The case of *Survaunt vs. Commissioner, 162 F.(2d), 753,* involves facts which are not analogous to those in the instant case. While there is similarity in some of the facts, it will be observed that there was no transfer of assets to liquidating Trustees, as took place in the instant case, which fact was strongly relied on by the Court of Appeals in reaching the conclusion that there was no reorganization. It is our insistence that, in the light of the difference in facts, there is no conflict in these two decisions.

In the petition for certiorari the contention is made that the lower Court did not consider the Survaunt case. This contention is hardly plausible in view of the fact that the case was strongly urged as authority in the Government's brief filed in that Court.

The Court of Appeals apparently gave full consideration to the authorities relied on by the Government in support of its contentions, and said:

> "Many authorities are cited by appellant in support of its contentions, and, in relying upon them, the government emphasizes that where transactions result in a new corporation which emerges and actually uses the transferred assets to continue the business with the same proprietary interests, such transactions amount to a reorganization. But the cases cited are not here in point, and circumstances disclosed, as above mentioned, are not in themselves controlling. See Glenn v. Courier-Journal Job Printing Co., 127 F. (2d) 820 (C.C.A. 6). Here, there was a liquidation of the old company, and, as said by Judge Simons in Mascot Stove Co. v. Commissioner, 120 F.(2d) 153 (C.C.A. 6), 'liquidation is the antithesis of reorganization'."
>
> (*R. 134*)

The case of *Helvering vs. Limestone Co., 315 U.S., 179*, relied on by Petitioner, on examination will be seen to materially differ from the instant case in its facts. The Helvering case involved a situation where a new corporation was formed by certain creditors of an older corporation, pursuant to a plan proposed by a Creditors' Committee, and where the assets of the older corporation were taken over by the new one through the medium of a sale in an involuntary bankruptcy proceeding. In the course of its opinion the Court pointed out that a transaction

may not qualify as a reorganization, even though the literal language of the statute is satisfied, without the necessary continuity of interest.

Various other cases are relied on by Petitioner, but it is our insistence that, on examination, they will be found to differ in their facts from the instant case sufficiently to make them not controlling or decisive of the issues here presented, and that hence they are not in conflict with the decision of the lower Court in this case.

CONCLUSION

If, under presently existing and applicable law, a taxpayer can save payment of taxes by some method which such law permits, this is his right; and it is a taxpayer's right to avoid a reorganization when it is in his interest to do so, if this is legally permissible. As was said by the Court of Appeals in its opinion:

> "It is to be observed, however, that the legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, by means which the law permits, can not be doubted. Gregory v. Helvering, 293 U.S. 465."
>
> (*R. 129–130*)

By way of summary, the position of the Respondents in this case is as follows:

The old company was legally dissolved under the laws of the State of Tennessee; it never had any transactions or negotiations with the new corporation; the conveyance of the assets of the old cor-

poration from the Trustees to the new corporation was never approved by resolutions of the old company; there was a bona fide conveyance for a valuable consideration by the Trustees to the new corporation, this breaking the continuity required for a reorganization; this plan, as carried out, was permissible and legal under applicable laws, both State and Federal; the Federal Government cannot, by regulations or arbitrary statutory interpretation, nullify or render non-effective that which is permitted by and legally done pursuant to a valid State statute; and that, therefore, there was no reorganization under the facts in the instant case. It is further insisted that the expenditures in question constituted ordinary and necessary expenses of the old corporation, and were hence deductible.

It is our insistence that the above conclusions, which are in accord with the decision of the lower Court, are correct and are supported by the following authorities:

Glenn v. Courier-Journal Job Printing Company, 127 F.(2d) 820 (C.A. 6th); Mascot Stove Company v. Commissioner, 120 F.(2d) 153 (C.A. 6th, cert. denied, 315 U.S. 802); Cushman Motor Works v. Commissioner, 130 F.(2d) 977 (C. A. 8th); Banner Mach. Company v. Routzahn, 107 F.(2d) 147 (C.A. 6th, cert. denied, 309 U.S. 676) (rehearing denied, 310 U.S. 656); Braicks v. Henricksen, 43 F. Supp. 254 (Dist. Ct. W.D. Washington S.D.) (affirmed 137 F.(2d) 632) (C.A. 9th); Klein Company v. Commissioner, 123 F. (2d) 871 (C.A. 7th, cert. denied, 315 U.S. 819); Helvering v. New President Corporation, 122 F.(2d) 92 (C.A. 8th); Bondholders Committee v. Commissioner,

315 U.S. 189; Real Estate Trust Company v. United States, 20 F. Supp. 20 (Dist. Ct. E.D. Pa.); Beverly Wallpaper Company v. Commissioner, 36 B.T.A. (F) 353 (reversed on another ground, 98 F.(2d) 211) (C.A. 3rd); Hay Foundry & Iron Works v. Commissioner, 33 B.T.A. (F) 144; Bazley v. Commissioner of Internal Revenue, 331 U.S. 737; Southwest Natural Gas Company v. Commissioner, 189 F.(2d) 332 (C.A. 5th); Shepard V. Commissioner, 101 F.(2d) 595 (C.A. 7th); Central Kansas Telephone Company v. Commissioner, 141 F.(2d) 213 (C.A. 10th); United States v. Cumberland Public Service Company, 338 U.S. 451; Herbert v. Riddell, 103 F. Supp. 369 (Dist. Ct. S.D. California C.D.)

For the foregoing reasons, it is respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

INTERNAL REVENUE CODE:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(g) (as amended by Sec. 121(d)(4) of the Revenue Act of 1943, c.63, 58 Stat. 21) Definition of Reorganization.—As used in this section (other than subsection (b)(10) and subsection (1)) and in section 113 (other than subsection (a) (22)).—

(1) (as amended by Sec. 213(b) of the Revenue Act of 1939, c. 247, 53 Stat. 862) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) Definition of Control.—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * *

(*Title 26 U.S.C.A.*,
Sec. 112(*g*))

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) (as amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798) Trade or business expenses.—

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or

other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * *

(*Title 26 U.S.C.A., Sec. 23(a)(1)(A)*)

1932 Tennessee Code:

SEC. 3756: DISSOLUTION.

Any corporation incorporated or which may be incorporated hereunder may surrender its charter of incorporation and dissolve itself in the following manner:

The stockholders of the corporation, at a meeting regularly called as provided in Section 3738, shall by a resolution adopted by the affirmative vote in person or by proxy of not less than two-thirds of the shares of stock entitled to vote, declare the desire of the stockholders to surrender the charter and dissolve the corporation, and direct the president and secretary of the corporation to file in the office of the secretary of state a sworn certificate showing the adop-

tion by the stockholders of such resolution as aforesaid. Upon the adoption by the stockholders of such resolution, the president and secretary of the corporation shall execute, under oath, a certificate substantially in the following form, to wit:

* * * *

The aforesaid certificate of the president and secretary of said corporation, together with the certificate of the notary public or county court clerk appended thereto, shall be filed in the office of the secretary of state and recorded in a book kept by him for that purpose.

The filing of said certificate in the office of the secretary of state shall operate as a surrender to the state by the corporation of all its corporate franchises and privileges, and shall have effect to annul the charter of said corporation, and its right to continue the corporate business shall thereupon cease and determine; provided, however, that the rights of the creditors of said corporation to the satisfaction of their debts out of the corporate assets shall not be prejudiced thereby; and provided, also, that the corporation shall continue to exist for the purpose of winding up its affairs so long as may be necessary for that purpose, but no longer, or otherwise.

* * * *

SEC. 3757. OFFICERS AND DIRECTORS AS TRUSTEES.

The officers and directors of said corporation in charge of its business and property at the time of such dissolution shall hold the assets thereof as trus-

tees for the benefit of the creditors and stockholders of the corporation, unless other persons are appointed for that purpose by said corporation or a court of competent jurisdiction; and such trustees shall have power to collect the debts due the corporation, sell such property of the corporation as may be necessary to pay its debts, and distribute the remaining assets, after the payment of debts and necessary expenses of administration, among the stockholders; and all suits necessary and proper to be brought in order to effect a settlement of the affairs of said corporation may be brought by said trustees in the name of the corporation, and no suit pending on behalf of or against said corporation at the time of the surrender of its charter in the manner herein provided shall abate because of such surrender, but may be prosecuted to final judgment or decree. In the case of any corporation dissolved by expiration of the time limited in its charter, said officers and directors of such corporation shall hold the assets as trustees, and shall liquidate the business of the corporation, in the same manner as herein provided in the case of corporations surrendering their charters.